United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2326

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 74-2326

In the Matter of
D. H. OVERMYER CO. INC. (California) No. 73 B 1131

Debtor-Appellant

-and-

ROBERT P. HERZOG

Receiver-Appellant

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR LANDLORD-APPELLEE TORRANO (San Francisco #3)

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BRIEF FOR LANDLORD-APPELLEE TORRANO (San Francisco #3)

QUESTIONS PRESENTED

1. Whether the District Court's affirmance of the Bankruptcy Judge's findings concerning the debtor-appellant's defaults, the resulting loss to appellee and the impracticality of the proposed arrangement, was in error where, based on a review of the record herein, said findings are not clearly erroneous.

2. Whether, in light of the aforesaid findings, the District Court correctly affirmed the Bankruptcy Judge's exercise of his equity powers in enforcing the lease termination clauses pursuant to Section 70-b of the Bankruptcy Act.

STATEMENT OF THE CASE

A. Introduction

On October 15, 1974, this Court, in denying appellants' motion for a stay, provided for an expedited appeal of this matter. The parties to this appeal have therefore agreed to proceed upon the briefs submitted to the District Court together with supplemental briefs concerning the opinion of the District Court. Accordingly, appellee's brief to the District Court is reproduced at the end of this supplemental brief.

B. The Undisputed Facts

On or about October 1, 1967, the debtor-appellant entered into a lease with appellee pertaining to a warehouse known as San Francisco #3. The aforesaid lease was for an initial term of twenty years with two five year renewal options. (P 3)* The fixed monthly rent for San Francisco

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* Parenthetical references are to Appellants' Appendix.

#3 payable to appellee amounted to $7,083.33. (P 4) In addition, pursuant to the terms of the lease, appellant-debtor assumed the responsibility of paying all taxes and of keeping the warehouse in good repair. (P 4)

Owing to defaults in the payment of rents to appellee, judgment against the debtor-appellant was entered in the Superior Court of California, County of Santa Clara, on November 14, 1973, for the amount of $21,084.48. (P 4) In addition, the debtor-appellant failed to pay the fixed rent for October and November of 1973 and the second installment of 1972-73 taxes. (P 11) All of the aforesaid, including the November 14, 1973 judgment, resulted in pre-petition defaults on the part of debtor-appellant in the amount of $49,170.00. (Receiver-Appellant's Brief, Schedule "A", page b) Subsequent to the debtor-appellant's petition in bankruptcy on November 16, 1973, the first installment of 1973-74 taxes became due in the amount of approximately $10,000.00. (P 11) This amount was not included in the receiver-appellant's Schedule "A", although recognized as a possible additional amount in the receiver-appellants' second footnote thereto.

The aforesaid Schedule "A" recites an "Annual Net Profit" for San Francisco #3 in the amount of $3,136.00.

A comparison of the Schedule "A" pre-petition defaults and net profits places San Francisco #3 as one of the six out of fifteen contested warehouses where the defaults are in excess of profits. Of these six warehouses, the amount in default compared with the profit figures for San Francisco #3 represents the largest disparity in pre-petition defaults over annual net profit.

C. The District Court's Opinion

In affirming the Order of the Bankruptcy Judge awarding possession of San Francisco #3 to appellee, the District Court, in specifically recognizing the requirement of Rules 752(a) and 810 of the Bankruptcy Rules that the court shall accept the findings of the Bankruptcy Judge unless they are clearly erroneous, stated:

> "This Court is convinced that there was no clear error by the Bankruptcy Judge with respect to the facts. It is equally persuaded that upon those findings the question which Judge Babitt was required to decide was one of law, i.e., whether upon the facts of this case and prior decisions in this Circuit he should exercise his discretion in equity to set aside the termination of the leases. . . ." (22)

In reaching this conclusion, the District Court had before it and gave due consideration to the lengthy record in these actions, including all the transcripts of the testimony taken at each individual trial before the

Bankruptcy Judge. Upon review of the record, the District Court had little trouble concurring with the Bankruptcy Judge's findings and held that:

> "The evidence with respect to the other cases [leases terminated under the bankruptcy clause] demonstrates a course of conduct on the part of Overmyer [debtor-appellant] which warrants the exercise of discretion in the landlords rather than appellants' favor." (23, 24-25)

ARGUMENT

POINT I

APPELLANTS HAVE FAILED TO ESTABLISH CLEAR ERROR ON THE PART OF THE BANKRUPTCY JUDGE OR THE DISTRICT COURT

The receiver-appellant asserts (Receiver-Appellant Brief, Point IV) erroneous findings of fact on the part of the District Court with respect to the landlords comprising a majority or the unsecured creditors; the value of the leaseholds and windfall to the landlords; and the debtors' conduct.

Although the receiver-appellant alleges error with respect to the landlords as a majority of the unsecured creditors, he does not offer or show how that error directly affects the correctness of the District Court's decision.

The receiver-appellant merely states that such findings "buttress the conclusion of the lower court that the debtors' plan or arrangement is unfeasible." (Receiver-Appellant Brief, p. 68) An analysis of the District Court's opinion, however, reveals that feasibility is not a necessary element of that court's decision but merely supports the lower court's decision to apply the equities in favor of appellees. The District Court's affirmance was soundly based upon a thorough review of the record before it, taking into consideration the repeated defaults on the part of the debtor and the inability of the debtor to meet its outstanding obligations. Feasibility, on the other hand, does not appear as a necessary element in the District Court's decision. As stated by the District Court:

> "The evidence. . .demonstrates a course of conduct on the part of Overmyer which warrants the exercise of discretion in the landlords rather than appellants' favor. This is especially so in light of the proposed plan of reorganization which simply cannot be characterized as feasible." (23, 24-25)

In addition, the receiver-appellant himself specifically disclaims the necessity of establishing feasibility in order to apply equitable considerations in determining forfeiture. (Receiver-Appellant Brief, p. 39) Accordingly, even assuming the validity of the receiver-

appellant's assertion of error, since such error pertains to a non-essential aspect of the District Court's decision, a reversal of that decision is not appropriate.

The receiver-appellant further complains that the value of the debtors subleases are "largely illusory". (17-18) Once again, however, the receiver-appellant does not claim that such a finding was essential to the District Court's decision. Rather, the receiver-appellant states that this finding was utilized to "bolster" the decision. (Receiver-Appellant Brief, p. 69)

Moreover, in the specific San Francisco #3 matter, the profitability of the sublease is negligible as demonstrated in Schedule "A" to the receiver-appellant's brief. Certainly, an annual profit of $3,136.00 cannot be considered essential to the debtors' plan for arrangement, whatever may be the details of such a plan.

Similarly, the appellants' protestations that forfeiture of the leases will constitute a windfall to the landlords is incongruous when measured against the profit-expense figures pertaining to San Francisco #3. After forfeiture, of course, appellee will have to assume the burden of overhead and operating expenses for the warehouse which, as set forth in Schedule "A", amounts to $20,000.00.

Since the present annual gross profit is $23,136.00 (Schedule "A"), the "windfall" to be realized by appellee is $3,126.00 annually. The actual operating cost to appellee, of course, must also include necessary expenses for repairs which, at the present time, amount to $12,000.00. (P 48) In comparing the total cost of the San Francisco #3 operation with profits, appellee will not even begin to realize its so-called "windfall" for at least four years hence. This state of facts certainly supports the conclusion of the District Court that the complained of windfall is "largely illusory".

Finally, the receiver-appellant asserts error by the District Court in finding "a pattern of consistent failure to meet its [debtor's] rent, repair, mortgage and tax obligations." (Receiver-Appellant Brief, p. 71) Although the receiver-appellant complains that no consideration was given to clearly contrary facts in the record (Receiver-Appellant Brief, p. 71), he nevertheless admits that such defaults by the debtor do, in fact, exist. (Receiver-Appellant Brief, p. 76) After discussing the facts attendant to each warehouse, the receiver-appellant concludes that the District Court's default findings, without regard to payments made in certain cases to reduce

arrears, constitutes error. (Receiver-Appellant Brief, p. 77) Nowhere in his discussion concerning San Francisco #3, however, does the receiver-appellant present facts or circumstances which would mitigate the debtor's prepetition defaults of in excess of $49,000.00. In fact, the record indicates that in early 1973, appellee commenced an unlawful detainer action against the debtor in lieu of which debtor stipulated to the payment of a certain monthly amount. Pursuant to the stipulation, the action was dismissed. The debtor, however, not only failed to pay the then current rents, but defaulted in its payments under the stipulation. Appellee thereupon obtained a subsequent judgment for an amount included in the pre-petition defaults. (P 15, 16)

Accordingly, rather than establishing facts which mitigate the debtor's defaults, the record herein is consistent with the District Court's finding of the debtor's repeated failure to meet its obligations.

POINT II

SPECIFIC FINDINGS OF FACT AS TO EACH PROCEEDING ARE NOT NECESSARY

Although the appellants protest that specific findings of fact were required with respect to each separate

proceeding, no authority has been cited to this court to support such an assertion. To the contrary, the District Court correctly held that Bankruptcy Rule 752 does not require detailed findings to support a decision of the Bankruptcy Judge. Woodmar Realty Co. v. Julius, 307 F.2d 591 (7th Cir. 1962), In re Metropolitan Realty Corp., 433 F.2d 676 (5th Cir.), cert. denied 401 U.S. 1008 (1970).

Moreover, a review of the record incorporating each proceeding makes clear that the essential facts, concerning the conduct of the debtor, necessary for the lower courts' decisions are succinctly set forth in the opinion of the Bankruptcy Judge. (34-36) Such procedure is, of course, specifically allowed in Bankruptcy Rule 752, which provides, inter alia:

> "If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein."

Accordingly, the District Court did not err in its conclusion that separate findings of fact were not necessary.

POINT III

THE EQUITABLE CONSIDERATIONS IN THE INSTANT CASE MANDATE FORFEITURE OF THE LEASE

Although, in Queens Boulevard Wine & Liquor Corp. v. Blum, ___ F.2d ___ (June 11, 1974, Docket No. 73-1512, Slip Sheet Opinion, p. 4117), this court refused to allow forfeiture of a lease pursuant to the bankruptcy clause contained therein, this court specifically limited its holding to the "particular circumstances of this case". (Slip Opinion at 4123) In addition, this court recognized its holding in Queens as an exception to the general rule that:

> "Bankruptcy forfeiture provisions are necessary for the protection of landlords and generally are enforceable." Slip Opinion at 4123.

Each matter must, therefore, be considered on a case-by-case basis after a thorough review of the evidence presented. Appellee respectfully submits that the record with respect to San Francisco #3 clearly establishes a pattern of defaults by debtor, combined with minimal sub-lease value and negligible, if any, windfall to appellee, sufficient to support the conclusion of the District Court that the Bankruptcy Court properly exercised its discretion in favor of the appellee.

CONCLUSION

For all of the foregoing reasons, the court should affirm the decision of the District Court in its entirety.

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of	:	
D. H. OVERMYER, INC. (incorporated under the laws of California),	:	No. 73 B 1131
Appellant-Debtor.	:	

BRIEF FOR APPELLEE TORRANO

Questions Presented

1. Whether the Bankruptcy Judge erred in terminating leases and awarding possession of leased premises to the landlord-appellee (Torrano) when the lease expressly provided for the termination thereof in the event the tenant shall file for an arrangement pursuant to the Bankruptcy Act, and where the appellant-tenant did so file on November 16, 1973.

2. Whether the Bankruptcy Judge correctly exercised his equity powers in the application of Section 70b of the Bankruptcy Act enforcing the lease termination clauses, where appellant-debtor was substantially in arrears; where the appellee

has realized a loss of approximately $59,000.00 as a result; where there has been no tender; and where the arrangement sought by appellants would provide for payment only over many years to the prejudice of appellee.

3. Whether the Bankruptcy Judge's findings concerning the appellant-debtor's defaults, the resulting losses to appellee, the lack of and impossibility of tender by appellants, and the impracticality of the proposed arrangement, should be accepted where, based on the record, they are not clearly erronecus.

Statement of the Case

Appellant-debtor is engaged in the business of long term leasing of warehouses from landlords such as appellee. In the course of this business, the appellant-debtor entered into a lease with appellee on October 1, 1967, pertaining to property and a building erected thereon known as 660 North King Road, San Jose, California.

Commencing in the summer of 1973, the appellant-debtor became in arrears of monthly rental payments to appellee

resulting in the entry of judgment against appellant in the Superior Court of California, County of Santa Clara, in the amount of $21,084.48. Appellee was, in addition, forced to pay approximately $12,000 in state and local taxes for 1972-73, and $10,000 for 1974, which amount was not covered by the aforesaid judgment. Finally, at the time of the trial of this matter, appellant-debtor owed an additional $14,166.60 for past due rent.

Pursuant to the aforesaid lease, appellee reserved the right to terminate same in the event certain specified events occurred. One such event, resulting in termination, was the filing for an arrangement by appellant-debtor pursuant to the Bankruptcy Act. On November 16, 1973, the appellant-debtor filed for an arrangement in this court pursuant to Chapter XI of the Bankruptcy Act.

As a result of such filing, appellee exercised its right pursuant to Article 15 of the aforesaid lease and, by notice dated November 29, 1973, elected to terminate that lease.

On November 29, 1973, the court appointed Robert

P. Herzog as Receiver* of the bankrupt's estates. Notwithstanding Article 15 of the lease and appellee's exercise of its termination rights thereunder, appellants refused to acknowledge said termination and refused to surrender possession of the property.

On December 6, 1973, appellee moved, by Order to Show Cause, for an order (1) directing the appellants to surrender the premises, and (2) terminating the December 15, 1970 lease. Pursuant to the aforesaid motion, a trial was held before Judge Roy Babitt on February 11, 1974.

The Bankruptcy Court's Opinion

In granting appellee the right to retake possession of the premises and terminate the lease, the Bankruptcy Court recognized and fully considered the import and purpose of a Chapter XI proceeding, including the court's equity powers thereunder. This consideration is reflected throughout the court's analysis of the operation of Section 70b of the Bankruptcy Act with respect to lease termination provisions. After a careful analysis of the equitable considerations

*The Receiver is likewise appealing the decision of the Bankruptcy Court to this court. Reference herein to the debtor and receiver collectively bears the designation "appellants".

presented however, the Bankruptcy Court found that such considerations did not overcome the clear import of Section 70b in this case. As stated by the court on page 29 of its decision:

> ". . . I am satisfied that given the enforceability of Section 70b of the Act and, inter alia, Finn v. Meighan, supra, the so-called equitable concerns are simply not robust enough to turn these landlords away. There is simply no strong public interest here to support such a result. The so-called 'windfall' to these landlords is part of what they bargained for and, as Circuit Judge Hays observes in his dissent in Queens Boulevard, slipsheet opinion at 4124-5, it is a factor in every case because unless a landlord could better himself he would never press for a judgment declaring a lease terminated."

Similarly, after a careful evaluation of all of the testimony presented, the court noted that the appellant-debtor's situation did not present the "appealing" facts found in Queens Boulevard Wine and Liquor Co. v. Blum, ___F.2d_____ (June 11, 1974, Docket No. 73-1512, slip sheet opinion p. 4117), nor were any of the "particular circumstances" of that case present in the instant case. The Bankruptcy Court accordingly concluded that, in the exercise of its equitable powers and in giving proper consideration to the equities presented, the

termination clauses in issue are enforceable and that possession should be granted to the appellee.

Statute Involved

Section 70b of the Bankruptcy Act provides, inter alia:

> "[A]n express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate is enforceable."

ARGUMENT

POINT I

APPELLEE GAVE PROPER NOTICE OF TERMINATION OF THE LEASE

At the trial of this matter held on February 11, 1974, appellants did not, and indeed could not, contest the fact that Section 15.01(b) of the December 15, 1970 lease between appellant-debtor and appellee provided that the filing of a petition for an arrangement under Chapter XI of the Bankruptcy Act constituted an event of default under said lease.

Furthermore, Section 15.02 of the lease, which sets forth the effect of such default, states, inter alia:

> "If an event of default shall have happened and be continuing, the Landlord shall have the right, at his election, then or at any time thereafter while such event of default shall continue, to give Tenant written notice of Landlord's intention to terminate the term of this Lease on a date specified in such notice, which date shall not be less than thirty (30) days after the date of giving such notice . . . ."

Pursuant to Section 15.01(b) of the lease, which relates to an event of default caused by the filing of a petition under the Bankruptcy Act, appellee properly gave notice dated November 29, 1973 by registered mail to terminate the lease.

Based on an undisputed literal application of the lease language to the instant case, and upon the proof presented at trial, the Bankruptcy Court had little trouble in finding that:

> "The receiver and the debtor do not maintain that the cast of the termination clause at issue here is insufficient to bring this case within the reach of the language of Section 70b. The provision of these leases is clear and

> unequivocal in its import and leaves no room for the court to strain to construe it narrowly to prevent the forfeiture which must follow if the intent as expressed by the language is clear. And if anything is an express covenant within the meaning of Section 70b, this termination clause is that." (Bankruptcy Court's Opinion, p. 19)

With this issue disposed of on an undisputed basis, the Bankruptcy Court went on to properly frame the remaining issue as:whether "an otherwise enforceable lease termination provision is rendered unenforceable in a bankruptcy case 'when compelling equitable and policy considerations so require.'" (Bankruptcy Court's Opinion, p. 20).

POINT II

APPELLEE'S RIGHT TO TERMINATE A LEASE UPON THE FILING OF A PETITION IN BANKRUPTCY IS AN ENFORCEABLE AND RECOGNIZABLE RIGHT

A clause in a lease that affords the landlord an option to terminate the lease upon the filing of a petition under the Bankruptcy Act has been repeatedly construed, in both state and federal courts, as a valid conditional limitation, enforceable against a receiver and tenant alike, to the language

of which the courts must give full and fair meaning. Finn v. Meighan, 325 U.S. 300, Murray Realty Co. v. Regal Shoe Co., 265 N.Y. 332; Gillette Bros., Inc. v. Aristocrat Restaurant, Inc., 239 N.Y. 87; Model Dairy Co., Inc. v. Foltis-Fischer, Inc., 67 F.2d 704, 706. Furthermore, a number of courts have held that a lease provision for termination of the term of the lease upon filing of a petition alone must be given full effect as an enforceable limitation of the lease. In re Scholtz Mutual Drug Co., 298 F. 539, 540; see In re Sound Inc., 171 F.2d 253 cert. den. sub. nom. Atwell Bldg. Corporation v. Sound, Inc., 336 U.S. 962; B.J.M. Realty Corporation v. Ruggieri, 326 F.2d 281, 282; Model Dairy Co. v. Foltis-Fischer, 67 F.2d 704; In re Atlanta Times, Inc., 259 F. Supp. 820, 828, affd. 383 F.2d 606; In re Dan Cohen Company, 221 F. Supp. 447.

Thus, in In re Scholtz Mutual Drug Co., 298 F. 539, the court held that in the absence of fraud or mistake, forfeiture of a lease under such a provision could not be restrained and that (at p. 540):

> "I am of the opinion that the parties had in mind, and agreed at the time they executed the lease, that it should be forfeited in the event of the filing of

> bankruptcy proceedings. That meaning is very clearly expressed, and it was unquestionably within the power of the parties to so contract. In other words, if the landlord did not want the lessee as a tenant after the happening of any of the events set forth in this clause, it had the undoubted right to make an agreement to that effect, and the lessee or its predecessor having agreed thereto, cannot complain, even though the enforcement thereof involves some hardship."

In asserting that equitable considerations render the termination clause unenforceable, appellants have placed great reliance upon In the Matter of Queens Boulevard Liquor Corp., ___ F.2d____ (June 11, 1974, Docket No. 73-1512, slip sheet opinion, p. 4117) to support its position. As the Bankruptcy Court incisively pointed out, however, Queens Blvd. involved a substantially different situation from the instant case. In Queens Blvd., a typewritten rider to that lease expressly provided against termination in the event of the filing of a bankruptcy petition as long as rent was promptly paid and the other terms and conditions of the lease met. The lease before the Bankruptcy Court in the instant case does not contain such a typewritten rider. The right of termination in this case is, therefore, absolute and qualitatively different from the limited rights of termination

existing in Queens Blvd. Moreover, the appellant-debtor here owed appellee approximately $21,000 in back rent and appellee has obtained a judgment against the appellant-debtor for that sum in addition to the payment of approximately $22,000 in taxes.

In addition, there exist at least five other factual differences which mandate the non-application of Queens Blvd. to the instant case. First, the tenant in Queens Blvd. offered the full rent owing. Second, the tenant had an $8,000 security deposit against which rent could be applied. Third, the tenant obtained a surety bond to cover its rent and payment to creditors. Fourth, the landlord at one point had accepted the tenant's offer, which it later rejected. Finally, the tenant in Queens Blvd. was able and willing to promptly pay its rent.

Unlike Queens Blvd., the appellant-debtor never tendered back rent and it is respectfully submitted that, at this juncture, it would be impossible for the appellant-debtor to tender rent so as to even come within the parameters of Queens Blvd. Moreover, none of the other above cited factors,

which weighed heavily upon the court's decision in Queens Blvd., are present in this case. Accordingly, it should be noted that the authority of Queens Blvd. is, at best, limited to the peculiar circumstances presented therein, since both the United States Supreme Court and the Second Circuit Court of Appeals have made clear that a covenant to terminate a lease upon the filing of a petition in bankruptcy is enforceable, Finn v. Meighan, 325 U.S. 300; B.J.M. Realty Corp. v. Ruggieri, 326 F.2d 281; see Speare v. Consolidated Assets Corporation, 360 F.2d 882, 887, and 11 U.S.C. §110(b). Writing for the Supreme Court in Finn, Mr. Justice Douglas, though recognizing that the Bankruptcy Court does not look with favor upon forfeiture clauses in leases, stated:

> "But an express covenant of forfeiture has long been held to be enforceable against the bankruptcy trustee. Empress Theatre Co. v. Horton, 266 F. 657; Jandrew v. Bouche, 29 F.2d 346. And the 1938 revision of the Bankruptcy Act made no change in that regard." 325 U.S. at 301

Moreover, as Judge Judd recognized in his Queens Blvd. decision, there are two lines of federal cases, one represented by the Supreme Court and Second Circuit decisions

upholding such lease clauses, and the other assuming an inherent equity power to modify the lease provisions no matter how expressly worded, in order "not to frustrate the purpose of the bankruptcy proceeding" (Decision, p. 7). Even assuming the wisdom of the latter line of cases, in the instant case the Bankruptcy Court gave full consideration to its equity powers, took evidence pertaining to the relative equitable positions of the parties, and made specific factual findings as a result of such testimony. The court's conclusion, of course, was that, in the exercise of its equity jurisdiction, appellee was entitled to terminate the lease and retake possession.

Those findings and resultant conclusion must be sustained by this Court unless clearly erroneous. In re Christ's Church of the Golden Rule, 79 F.Supp. 42 (D.C. Cal. 1948); In re Los Angeles Land & Investments, Ltd., 447 F.2d 1366 (C.A. Hawaii 1971). As discussed herein, the facts presented do not place this case within the parameters of those cases allowing the restraint of forfeiture. Accordingly, appellee submits that nothing exists in the trial transcript or the full record which would support a finding by this Court

of clear error on the part of the Bankruptcy Court.

CONCLUSION

For all of the foregoing reasons, the court should affirm the Bankruptcy Court's decision terminating the lease and allowing appellee to retake possession of the premises.

Respectfully submitted,

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